

NOTE 5 – TREASURER’S COMMON CASH

General Accounting Policies

The State Treasurer manages the State’s Common Cash pool, which is used by most state funds. The pooling of cash allows the Treasurer to invest monies not needed to pay immediate obligations so that investment earnings on available cash are maximized. Investments of the pool are not segregated by fund; rather, each contributing fund’s balance is treated as equity in the pool, and presented in this report as “Equity in common cash.” Many funds, including pension (and other employee benefit) trust funds, use their equity in the pool as a short-term investment vehicle.

All negative balances in the pool are reclassified at year-end as interfund liabilities. If the negative balance is considered long-term, the reclassification is recorded as an advance.

Statute or administrative policy determines whether a particular fund receives or pays interest on its balances in the pool. If a fund does not receive or pay interest, the General Fund receives or absorbs such amounts. The State Treasurer has placed a “cap,” or limit, on the amount of interest that can be earned by some State funds. These “capped” funds are limited to a maximum rate determined by the State Treasurer. For the remaining “uncapped” funds, earnings on positive balances and charges on negative balances are allocated quarterly based upon the average daily balances of the various funds and the average investment earnings rate for the quarter. Accrued earnings of the pool are recorded as assets, with the accrual allocated to the various funds’ equity in the pool.

Interest revenues on positive balances and interest charges on negative balances are reflected as revenues or expenditures/expenses of each of the participating funds.

Investments and Deposits

The investment authority for the Common Cash pool is found in Michigan Compiled Laws (MCL) Sections 21.141 - 21.147. The State Treasurer may invest surplus funds belonging to the State in bonds, notes, and other evidences of indebtedness of the United States Government and its agencies and in prime commercial paper. Certificates of deposit are permitted in financial institutions whose principal office is located in the State.

The Treasurer invests excess cash in short-term investments or cash equivalents. The law does not prohibit the Treasurer from entering into repurchase agreements; however, the Treasurer did not use these agreements in managing the pool in fiscal year 2007.

Statutes provide for certain special state investment programs for which the General Fund is credited (charged) for earnings in excess of (under) those achieved by regular pool investments. To date, these programs have not resulted in any principal losses.

Emergency Financial Assistance Loan Program: This program provides for emergency loans to local units of government, and is the most significant of the special investment programs. The Emergency Financial Assistance Loan Board, established by MCL Section 141.932, administers the program. The Treasurer may not loan more than a combined total of \$5.0 million in any one fiscal year to qualifying cities, villages, or townships in amounts as approved by the Board.

In fiscal year 2000, the Emergency Financial Assistance Loan Board was authorized to approve the lending of up to \$159.9 million to Wayne County to finance the payment of certain obligations to the State. The outstanding balance at September 30, 2007 was \$50.6 million. The interest rate is reset July 1 of each year in accordance with the loan agreement. Loan repayments by the County are supported by provisions of the loan agreement and legislation that pledge the County’s share of a portion of the State taxes collected on cigarette sales. There were no repayments on the loans in fiscal year 2007.

Michigan Marina Dredging Loan Program: MCL Section 21.142d provides for a program under which financial institutions may make low-interest loans to eligible marinas for dredging costs necessitated by low water levels to accommodate the use of the marina by recreational watercraft.

Under this program, the Department of Treasury and a financial institution may enter into an investment agreement under which the Department of Treasury will invest the State’s Common Cash with the financial institution at an agreed upon interest rate (generally 1.5 percent per annum). The financial institution will then use the principal to make a low-interest loan to an eligible marina.

The maximum amount of a Michigan marina-dredging loan is \$75 thousand per marina. The total amount of outstanding loans is statutorily limited to \$20.0 million. The loans accrue interest at a rate of six percent and the loans’ terms may not exceed seven years. Other details about the loans are available in the investment agreement. As of September 30, 2007, the program expired and there were no outstanding loans; repayments during the year were \$28.6 thousand.

Michigan
Notes to the Financial Statements

Michigan Sugar Beet Loan Program: MCL Section 21.142e provides for a program in which the State may make no-interest loans from the Common Cash pool to sugar beet growers' cooperatives for the purpose of buying the assets of agricultural processors who are in or have recently been in bankruptcy proceedings.

The loans may not exceed \$5.0 million in total. MCL Section 21.142e was amended, effective March 22, 2007, to extend the loan periods to a maximum of 10 years. As of September 30, 2007, loans outstanding totaled \$2.4 million and will mature on October 11, 2011.

The State Treasurer, as part of a modification to the loan, is required to subordinate a loan of not more than \$5.0 million to the primary loan of a sugar beet growers' cooperative (Michigan Sugar Beet Growers, Inc.) and relinquish any enforcement powers or authority that may exist under the current contract or agreement. However, the amendment to MCL Section 21.142e also provides that if a quarterly payment is missed by the borrower after February 15, 2007, the entire loan is in default and is due and payable immediately, in full.

Agriculture Disaster Relief Program: MCL Section 21.142a created this program to provide loans to assist farmers and businesses suffering losses as a result of a disaster. Financial institutions (banks) making these loans can have the cost of the loan covered by 1) earnings on funds deposited by the State, or 2) a subsidy of the cost.

The maximum loan is \$150 thousand (\$200 thousand under certain circumstances) to farmers and \$400 thousand per legal entity to businesses. The total amount the State may deposit under this program is \$30.0 million. Of that amount, no more than \$10.0 million may be allocated to qualified agricultural loans made to businesses. Details on what constitutes a qualified loan can be found in the statute. Loans must be made before October 1, 2002, and must be repaid by October 1, 2007.

As of September 30, 2007, the program expired and there was no outstanding balance. During the current fiscal year, subsidy payments totaled \$1.5 million and repayments totaled \$34.7 million.

Assets and equities of the Common Cash pool as of September 30 were as follows (in millions):

Assets	
Cash on hand	\$ -
Demand deposits	203.2
Time deposits - regular	1,524.1
Time deposits - Marina Loan Programs	-
Time deposits - Agricultural Loan Program	-
Prime commercial paper - at cost	298.9
Interest receivable	5.0
Emergency loans to local units - at cost	52.6
Michigan Sugar Beet Loan Program	2.4
Total assets	<u>\$ 2,086.2</u>
Equities	
Fund equities (net) in Common Cash (1):	
Governmental activities	\$ 1,637.5
Business-type activities	77.8
Fiduciary funds	251.8
Discretely presented component units	119.1
Net fund equities	<u>\$ 2,086.2</u>

(1) Negative equity balances in the pool are reclassified at year-end as interfund receivables and liabilities. Current balances are included with "Amounts due from other funds" and "Amounts due to other funds" and long-term amounts are classified as interfund advances. Note 17 summarizes interfund receivables and liabilities.

The following paragraphs provide disclosures about deposits and investments of the Common Cash pool, as required by GASB Statement No. 3 as amended by Statement No. 40. Please see Note 8 for information about deposits and investments that are not part of the Common Cash pool.

Common Cash Deposits

Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the State's deposits may not be recovered.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

Uncollateralized

Collateralized with securities held by the pledging financial institution, or

Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

The State Treasurer's policy requires the following criteria to lessen the custodial credit risk: all financial institutions holding the State's money must pledge collateral equal to the amount of the account balance for all demand and time deposits, to secure the State funds. A bank, savings and loan association, or credit union holding State funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the State of Michigan. No deposit in any financial organization may be in excess of 50 percent of the net worth of the organization.

At September 30, 2007, the carrying amount of deposits, including time and demand deposits, was \$1.7 billion. The deposits were reflected in the accounts of the banks at \$1.7 billion. Of the bank balance, \$4.0 million was covered by federal depository insurance, \$1.7 billion was collateralized with securities held by the State's agent in the State's name, and \$2.6 million of demand deposits was exposed to custodial credit risk and was uninsured and uncollateralized. Compensating balances kept in demand deposit accounts to avoid service charges totaled \$113.6 million at September 30, 2007.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

MCL Section 487.714 requires State deposits be held in a financial institution which maintains a principal office or branch office located in the State of Michigan. The State had no Common Cash deposits subject to foreign currency risk at September 30, 2007.

Common Cash Investments

Types of Investments

Common Cash investments include prime commercial paper, corporate notes, and emergency municipal loans.

Risk

In accordance with GASB Statement No. 40, investments also require certain disclosures regarding policies and practices with respect to the risks associated with them. Custodial credit risk, credit risk, and interest rate risk are discussed in the following paragraphs.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the State will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either:

The counterparty, or

The counterparty's trust department or agent but not in the government's name.

The State Treasurer does not have an investment policy for managing custodial credit risk. At September 30, 2007, Common Cash investments were not exposed to custodial credit risk.

Credit Risk

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

Prime commercial paper investments must be rated A-1 or P-1 at the time of purchase as rated by the two major rating services: Standard and Poor's (A-1), and Moody's (P-1). Borrowers must have at least \$400.0 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10% of a borrower's outstanding debt. The investments are further limited to \$200.0 million in any borrower, unless the borrower has an A-1+ rating, in which case the investment is not to exceed \$300.0 million. The sugar beet loans are evidenced by unrated zero interest promissory notes.

Emergency municipal loans are evidenced by unrated notes held by the State in the State's name. At September 30, 2007, prime commercial paper investments were rated at A-1 or P-1.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The State Treasurer's policy states that cash equivalents are invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk. At September 30, 2007, the fair value of cash equivalents was \$1.8 billion; the weighted average maturity was 19 days.

The State Treasurer does not have a policy for controlling interest rate risk regarding the Common Cash special loan programs described earlier. These loan programs are investments created through legislation. Although some interest rate risk exposure exists, this risk is not a consideration when entering into these loan programs.